EUROPEAN INVESTMENT BANK

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4 November 1997

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DRAFT : ***please provide the Secretariat, preferably in writing, with any requested amendments, if possible before the next meeting on 21 October 1997***

BOARD OF DIRECTORS

Minutes of the meeting held in Luxembourg
on 15 September 1997 at 9.00 a.m.

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I - general questions

5. THE CAPITAL STRUCTURE OF THE BANK IN A MEDIUM-TERM PERSPECTIVE

5.1 Paper prepared for the Special Meeting on 21 July 1997 (reprint)

5.2. Legal aspects and related considerations

Before turning to Documents 97/243 and 338 on the Agenda, the CHAIRMAN briefly outlined the general state of progress in the Board's strategic discussions, recent developments and the next steps to be taken by the Board itself.

The day's meeting had been called primarily to resume discussion on the outstanding points that the Board had had insufficient time to cover at the two-day July meeting, mainly in consequence of the time it had had to devote to discussing the Amsterdam Special Action Programme - ASAP. The Bank had received the Governors' unanimous endorsement of ASAP on 20 August and matters had progressed rapidly, as the President had reported the previous Saturday to the informal ECOFIN. A copy of his statement to ECOFIN was circulated to those attending.

The aim at the present meeting was to make good progress in the debate on the July paper (Doc 97/143) "The Capital of the Bank in a Medium-term Perspective". The Chairman regretted that it had been necessary to cut off that discussion, but a number of views were on record in the Minutes (AUS, D, DK, E, GR, IT, S, UK and the Commission) supplemented by the written contributions of Paul McIntyre and Francis Mayer.

In order to get the discussion going again, the Chairman recapitulated on how far the Board had progressed following the original Awayday on strategic issues in January 1997.

(i) Notwithstanding much subsequent discussion, the Board had given its general endorsement of the broad strategic approach in the January paper "Framework for the next 5-10 Years" (in essence, that the Bank's focus should be on the "economic periphery" of the Union) on the basis of which our discussions have proceeded since then.

(ii) The discussions had seemed to point to the need for a twin-track follow-up, looking on the one hand at the broad range of questions concerning the Bank's capital and on the other at what the Management Committee called "modernisation issues" (e.g. loan pricing, new products, EIB/EIF partnership, performance indicators and so on) : it had set out a number of these in the Forward Programme distributed to Members at the June Board meeting (Doc. 97/195).

(iii) However, since February, proceedings had in a sense been diverted by three new major developments :

- the first, consideration of options for the disposal of the Bank's operating surplus, following the debate at the February Board meeting and the proposal that all or part of this - or indeed of other components of the Bank's own funds - should be distributed as a one-off payment or series of continuing payments to the shareholders. This had to be settled before any Board position could be finalisedon the other capitalisation issues. The only formal decision taken so far had been that at the Annual Meeting in June, that the Bank should fund all outstanding contributions to the 1990 capital increase;

- the second major development had been the Amsterdam Special Action Programme - ASAP, which had caused a number of other matters to be shelved. Finance Ministers clearly attached great importance to ASAP, and the first operational priority within the Bank had to be to get the programme under way as quickly as possible. The Management Committee would be bringing the first financing proposals under the Programme to the Board early in October and at subsequent Board meetings in 1997.

The Bank was also in intensive discussions with the European Investment Fund, on the creation of a new "European Technology Facility" to provide venture capital to high-technology SME projects. It was hoped the relevant proposal would be ready for submission to the next Board Meeting on 1 October and to the meeting of the EIF Supervisory Board on the same day.

- the third complicating factor was the complex and difficult question of the legal and statutory implications of the various suggestions and proposals that had been put forward. The Management Committee stood by the findings it had received from the Bank's own and outside legal experts. But it recognised the doubts of some Board Members ; hence the paper and the proposal (Doc 97/338) now put to Directors, for further examination of these issues by a temporary Board of Directors Working Party. Should the Board decide to go ahead with that approach, the Management Committee would do all possible on the Bank's side to expedite proceedings.

Returning to the strategic discussions in general, the Chairman reminded the Board that the wider "capitalisation questions" had been taken forward by Paper No 2 to the Special Board Meeting on 17 April, and the objective must be to present to the Governors at or beforethe 1998 Annual Meeting a general submission on the next increase in the Bank's capital, set in an agreed strategy context. As Document 97/243 pointed out, if there was no increase in the capital in 1998, new lending would have to fall to ECU 18 billion in 1999, and less thereafter, which, in the Chairman's view, was impossible to reconcile with the mission of the Bank and the expectations of the Member States. The Chairman emphasised his conviction, often articulated, that the increase must be sufficient to take the Bank beyond the introduction of EMU and at least into the early stages of enlargement, bearing in mind the increasing burdens being placed on the Bank.

So far as the so-called "modemisation issues" were concemed, the Bank was doing further work and the Management Committee would bring these to the Board over the coming scheduled and additional meetings: The Chairman would circulate a new Forward Agenda with a tight work programme to cover these. This might still need to be flexible in order to cover the huge new agenda before the Board and at the same time to enable it to discharge efficiently its ongoing operational responsibilities. There would be some tight targets and deadlines. It was, however, particularly important for the question of surpluses, and possibilities for their disposal, to be settled very soon, especially if any decisions, as requested by some shareholders, were to be taken before the end of the curmt year. The Working Party on the legal and statutory aspects - if established - would have to act quickly, especially if it wished to contemplate options outside the scope of the existing Statute.

Mr MUSCA observed that consideration of the capital increase implied studying other related problems such as the proportion of **paid-in**, the future volume of the **reserves**, prospective capital requirements and the development of Bank activity, all of which called for agreement on a timetable. He thought that priority should be attached to defining the period to be covered by this capital increase, which should extend up to a date prior to accession of the Central and Eastern European countries, given that the level of Bank operations in the CEEC was not predictable.

Taking up another point, Mr MUSCA noted that the Bank's future activity - which was, needless to say, the main element to be taken into account in deciding the capital increase - was in part subject to more effective application of the **subsidiarity principle**. Consideration needed to be given to the means of translating this essential principle into reality in operational terms; similarly there was a case for thinking of reduced mark-ups for certain types of operation. He confirmed his support for the creation of a **Working Group** and concurred with other Directors that its terms of reference could be widened to include legal experts, possibly from the Commission or the Council (since such experts were in a position to throw interesting light on the Treaty and the Bank's Statute).

Mr VANORMELINGEN was of the opinion that the capital increase ought to cover a period of least 5 years to enable the Bank to plan its future operations in a manner consonant with normal development of the Union's economic and financial policy. Since new member countries were unlikely to join the EU before 2003-2004, it was not necessary to allow for the impact of enlargement.

To Mr VANORMELINGEN's mind four principles could be explored with a view to moderating the extent of the capital increase, namely those of: (1) correcting the current trend towards increasingly approaching the **50% threshold in relation to the Bank's contribution to estimated project cost**; (2) examining the advisability of making more effective use of the **subsidiarity principle** by seeking greater cooperation with commercial banks and the private sector; (3) gearing project selection more to considerations of **value added**; (4) limiting **lending outside the Union to 10%** of aggregate financing calculated on an annual basis rather than cumulatively as a proportion of the EIB's ceiling on aggregate commitments, on the understanding, however, that it would be inappropriate to include loans in the countries candidates for accession within this figure of 10%.

Turning to the percentage to be **paid in**, which had decreased over the years, Mr VANORMELINGEN thought that this might be set at a level of 5% or 6% for the next capital increase provided that this was acceptable to the market. He also hoped that the **statutory reserve** of 10% could be built up very quickly: a decision to this effect would be given a favourable reception by the market, given that this reserve was the Bank's best guarantee against any significant problems on the operational front; it would also mean that, each time a new financial year came around, the EIB would not have to think again about building this reserve up. He felt that the **Working Group** should take the form of a slimmed-down committee consisting of one member per country rather than of a Director and his Alternate at the same time.

Mr REINESCH was in favour of a capital increase of 75% as from 1999. He could accept that the **paid-in** element be reduced to 6% and seconded the opinion that the **statutory reserve** should be built up promptly to a level of 10%. He believed that any free reserves should then continue to accrue to the Bank inasmuch as the latter's role was set to grow further.

Mr RAVASIO believed that the period covered by the next capital increase should be kept to no more than four or five years in view of a number of imponderables, mainly in terms of future loan demand, the euro, EMU, market integration and the implications in five or six years' time of accession of the new Member States for trends in Bank financing. Referring to the Board papers under discussion, he noted that an increase in capital of 50% would enable the EIB to continue lending up to 2003 inclusive at an annual rate of growth of 7.5%, a criterion which he felt could be taken as a yardstick for the debates ahead.

Addressing the issue of distribution of **dividends**, Mr RAVASIO wondered whether it might not be possible to arrive at a once-for-all payment to the Member States of a lump sum of around ECU 500 million from the reserves. This would be a quick way of solving the dividends problem and would help to simplify discussion of the capital increase.

Any legal problems could, if necessary, be obviated by maintaining that no dividends as such had strictly speaking been distributed but rather that the Bank had made a technical adjustment to its reserves after analysing the level of its own funds.

Drawing attention to the fact that it was proposed to finance the **paid-in** element of the increase from reserves, Mr RAVASIO queried whether other alternatives were not feasible such as raising liquidity through the sale of assets, i.e. securitisation of part of the Bank's loan outstandings. He did not feel that the Bank needed to hold on to its loan assets for a very long period. Indeed, divesting itself of its assets would enable the EIB, among other things, to increase its operations outside the Union while at the same time keeping that part of its portfolio of loans for those countries in the Union to within acceptable proportions. Furthermore as regards the **gearing ratio**, he queried the need to continue to treat loans guaranteed by Member States as part of loans outstanding given that such operations offered no risk element. He also wondered whether the reserves should be included in this ratio - or whether, as at present, calculations should be confined to subscribed capital - particularly since the reserves were, to all intents and purposes, capitalised.

With developments in Bank lending policy exposing the EIB to increased risks, Mr RAVASIO thought that the EIB should in future avoid giving the impression that its entire portfolio would be exposed to greater risks each time the Bank engaged in a new area of high-risk lending activity. This argued in favour of agreeing in advance the volume of the lending package in respect of which the Bank was willingly prepared to accept higher exposure.

Anxious to define the terms of reference of the **Working Group** in such a way that the range of its prerogatives was not subject to conflicting disputes, Mr RAVASIO recommended that its key objective should be the consideration of legal matters together with any other issues which the Board of Directors might request it to discuss. The Group should be chaired by a member of the Management Committee, thereby guaranteeing appropriate feed-back to and from the rest of the Board.

Mr de VRIES favoured debating capital increases at regular intervals and not necessarily every ten years. From this standpoint, he felt that an increase of 50% was quite sufficient. He also counselled against the goals pursued during the period embraced by this capital increase extending beyond the objectives of the present Union of 15 Member States. The issues of **subsidiarity** and eligibility needed to be dealt with in tandem; it was vital to rethink the former criterion, particularly now that there was hardly a sector in which the Bank was not authorised to provide financing. Before any decision was taken on the capital increase, the Board ought to discuss, side-by-side with the subsidiarity issue, Bank policy in terms of coping with the EIB's increased risk exposure. Another point to be taken up beforehand was that of **surpluses**. Moreover, it would be interesting to compare simulations based on different levels of capital increase, such as one of just 25%; this could give rise to a number of enlightening conclusions, especially as regards definition of priorities.

Mr de VRIES did not believe that the Board should waste time debating the legal ramifications of the use of surpluses; it was for the Management Committee to indicate, after due analysis, what was and was not feasible. He added that the Netherlands was opposed to distributing **dividends** as a one-off exercise and he wanted the matter to be debated so that he could defend this point of view. Finally, he felt that Directors could delegate their Alternates to stand in for them on the **Working Group**; there was also a case for inviting a legal adviser to take part in the meetings. At all events, he felt that the Working Group should be able to decide its own priorities in terms of problems to be discussed by it in connection, either directly or indirectly, with the capital increase.

Mr McINTYRE supported the idea of the **Working Group** being given a wider remit, not solely limited to legal issues (although it should have access to legal advice) or the 1996 surplus. In fact, there was a clear linkage between considerations of strategy and distribution of **dividends**, on the one hand, and legal aspects, on the other, and it had to be possible to debate these at one and the same time. The Working Group should report to the Board of Directors within a relatively short space of time, preferably by January 1998. He also thought that Alternates should be authorised to attend Working Group meetings.

For Mr McINTYRE, the major capital increase issues comprised the size of this increase, Bank **strategy**, modernisation, lending **priorities**, redistribution of **reserves** and the remit of the Working Group. He wondered what sums would be available for possible distribution to shareholders over the next five years or so. Patently, these questions had to be taken forward before any decision was put to the Governors on the increase as such.

Mr McINTYRE also favoured being provided with different scenarios based on capital increases of 25% and 50%, making it possible to draw worthwhile conclusions as to the impact in terms of gross lending volumes over the short and long term, as well as prospective policy on **the disposition of excess reserves**. Furthermore, the Bank should decide on those areas or categories of borrower henceforth ineligible for Bank finance (e.g. multinationals, which were able to meet their funding requirements from their own resources or on the capital markets).

In addition, before assessing other financial problems, Mr McINTYRE would have welcomed a document indicating the appropriate **ratios** for non-risk-weighted and risk-weighted lending. He also asked that the Board be given the opportunity to discuss the **Pre-Accession Facility** before the end of the year; it would also be preferable to debate **loan pricing** as soon as possible, given its key importance for Bank strategy.

Ms BARATA was convinced that a capital increase was necessary and that it should be financed from the Bank's reserves. Even with lending growth rates of some 7.5% or even 10%, a capital increase of 75%, if not 50%, would suffice, particularly since it needed to be limited to a period catering neither for enlargement nor for imponderables linked to the impact of the euro on the markets. It was also her feeling that a slight reduction in the **paid-in** ratio would not affect the EIB's credit rating. Finally, she was in agreement with the Bank's proposals on the establishment of a **Working Group**.

Mr WIESER observed that discussions on the capital increase were closely associated with issues which went beyond the strict terms of reference of the EIB, viz. further reform of the Structural Funds under the Commission's Agenda 2000. This reform would impact on Bank activity in the Cohesion Countries. He regretted that the Commission had not borne in mind the reasonable approach set out in the document on Bank strategy in terms of the EIB's role in reform of the Structural Funds. There was no contesting the fact that this reform would have repercussions for EIB activity and the capital increase.

Mr WIESER also felt that the capital increase, distribution of dividends and strategy were closely interlinked and should be debated as a whole. In the circumstances, there was scope for giving the **Working Group** wider terms of reference. In his view, an increase of less than 100% would be appropriate and he suggested a figure of 50%; in common with other speakers, he favoured simulations being conducted to cover a range of increase scenarios. In any event, the conclusions of the forthcoming ECOFIN Council meeting in Luxembourg would have implications for all of these issues. On the organisational front, Mr WIESER preferred longer meetings so as to expedite discussions and to limit the amount of time lost in travel.

Mr JOHANSSON inclined towards a more modest capital increase than that proposed in the Board paper, especially as the Bank's needs would have to be reviewed when it came to enlargement. He also believed that the **Working Group's** remit should be extended; he felt that Alternates as well as an external legal adviser should be included in the **Working Group**, which should report to the Board of Directors by next January.

In the light of Document 97/243, Mr FERRER wondered whether a change in lending policy would really impact on volume growth. He was of the opinion that the paper could serve as a basis for discussion, but no more than that. He also favoured setting up a **Working Group**, which should help to speed up the decision-making process; a timetable of meetings should be established without delay.

Mr GRILLI was persuaded of the need for a capital increase, if the Bank was to be able to continue its mission and develop its **strategy**. Although this increase should be funded from the Bank's own resources, such a step had to go hand-in-hand with the decisions on long-term financing strategy as well as on modernisation, notably at the level of disposition of the **reserves** and **dividends** policy. The mandate of the proposed **Working Group** could be extended to these issues.

To Mr SAUPE's mind, there were three inseparable elements: the capital increase, Bank strategy and distribution of **surpluses**. All three topics ought to be put to the Governors at the same time. The latter had, in particular, to be able to judge whether the level of the Bank's commitment should be kept unchanged, reduced or increased. Capital increases provided shareholders with an appropriate opportunity to debate an institution's financing policy and it was important to allow them to make the most of this opportunity.

The speaker then turned to a number of points to be borne in mind in deciding the next capital increase. He thought that account should be taken of the incidence of the euro on the markets, the impact of **subsidiarity** on the range of Bank operations and the measures to be adopted in relation to the Structural Funds. The Bank would also have an important part to play in the context of the **Pre-Accession Facility**; priorities calling for support in specific sectors within the CEEC (such as finance for water schemes) should similarly influence the volume of lending made available in these countries, although their absorptive capacity needed at all events to be analysed. In short, if the Governors were to be presented with convincing arguments, credible capital increase scenarios of the order of 25% or 50% should be envisaged, all the more so as growth in annual financing volumes in the region of 7.5% to 10%, as advanced in the Board papers, appeared to him unrealistic. He felt that a period of 4 to 5 years for the next capital increase was reasonable.

In the same vein, Mr SAUPE wondered whether future developments might not force the Bank to reconsider its sectoral policy (which currently allowed it to conduct operations in just about every sector) and raised the question as to how the EIB could increase the leverage effect of its financing; he thought that there might be a case for reviewing the **amounts** in percentage terms **lent in relation to estimated project costs** and, on another tack, that it might be appropriate to include own resources in the **gearing ratio**.

Mr SAUPE went on to express regret at the fact that ASAP had been formulated and implemented without first consulting the Board of Directors. Turning to the issue of the proportion of **paid-in** to subscribed capital, he was of the opinion that this should be discussed in depth, adding the reminder that at the World Bank, the paid-in element amounted to 5% of subscribed capital. In conclusion, Mr SAUPE believed that the terms of reference of the **Working Group** should extend beyond purely legal questions (it could enlist the services of an outside legal consultant) and be framed first and foremost with a view to addressing ways of structuring the policy on **surpluses** (both for 1996 and for future years), against the background of the capital increase. Directors should be able to delegate Alternates or other Board members to represent them.

Mr TYBJERG cautioned his colleagues on the Board against sanctioning too modest a capital increase, which would not enable the Bank to carry out its mission properly, and therefore felt that an increase of 50% would be inadequate. He hoped that the capital provided from the **reserves** could be called in one full instalment. He also favoured the **Working Group** seeking outside legal advice.

In the eyes of Ms GRÖHN, the capital increase, which was above all a function of the role the Bank intended playing in the years ahead, had also to allow for economic developments within the CEEC and commitments under the **Pre-Accession Facility**. As regards the tasks of the **Working Group**, the legal question was to her mind crucial and had to be dealt with in conjunction with the other issues for debate. She could agree to Alternates and an external legal adviser attending the meetings.

Mr PAPAGEORGIOU also believed that the capital increase, **reserves** policy and Bank **strategy** were part and parcel of the same issue. On the question of strategy, in keeping with ASAP, priority should be accorded to health and education. The proposed **Working Group** should come forward with recommendations on reserves policy and the capital increase, and it should not confine itself to studying legal matters. The Group should submit its conclusions to the Board of Directors by the end of the year.

For Mr MERINO, it was important that the capital increase take account of the uncertainty surrounding **enlargement**, **trends in Bank lending**, the EIB's **gearing ratio** and the future shape of EMU. The level of this capital increase could not be decided without analysing these parameters; in any event, the period covered should be limited in time.

Mr BOEHMER shared Mr RAVASIO's view that the Bank did not need to retain in its portfolio loans to first-class borrowers; it should put such assets on the market as rapidly as possible. On another subject, the Bank should make more effective use of its authorisation to furnish **guarantees**, which would help to cut back on the level of its lending. All this could have a bearing on the Bank's capital requirements; the same would hold true if the EIB endeavoured to reduce the **proportion of its lending in relation to estimated project cost**.

Mr BOEHMER also felt that only loans actually disbursed, rather than those approved and awaiting disbursement, should be included in the **gearing ratio**. He added that he favoured giving the **Working Group** a wider remit.

Mr PONTOLILLO was of the opinion that the capital increase ought to be decided by the Board of Directors and not by a Working Group. The latter's task should be to debate the distribution of **surpluses**, not only those for 1996 but also those for future years. He thought that there were grounds for examining **risk and gearing ratio** levels and for considering other methods of calculating these. Another question to be raised was whether it was appropriate for the Bank to hold on to all its loan assets. Finally, Mr PONTOLILLO favoured the inclusion of Alternates in the **Working Group** and consideration of its conclusions, in the final analysis, by the Board of Directors.

On the matter of timing, the CHAIRMAN stressed that the question of the capital increase and the associated discussions would have to be brought to a conclusion at the latest by the meeting of the Board of Governors in June 1998. This clearly meant getting on with the discussions very quickly indeed within the Board of Directors so as to wind matters up in good time.

As regards the question of **excess funds or surpluses**, he noted that two possibilities had been raised by Directors, one being whether there should or should not be a distribution to shareholders, the other being, if there were such a distribution, whether this should take the form of a one-off payment or a series of payments. The legal, statutory aspects had still to be addressed.

On the matter of future **strategy**, he observed that the main concerns were those of reaching agreement on priorities, attaching greater importance to **subsidiarity**, introducing new lending instruments and strengthening cooperation with the Commission in future developments on EU regional policy. At all events, it was proposed that the issues put to the Governors be confined not solely to the capital increase but encompass other closely interrelated questions, notably distribution of surpluses and strategy.

Reverting to the size in percentage terms of the capital increase, the CHAIRMAN highlighted the fact that the Bank had, among other considerations, been invited to launch a substantial **Pre-accession Facility** and that Ministers had not asked the EIB in any way to limit its operations in different countries; rather, the Bank was called upon not to interrupt its unbroken line of support for non-member countries. These considerations, among others, suggested that the capital increase could not be scaled down if the EIB was to continue to live up to all that was expected of it

Focusing on the question of the **Working Group**, the Chairman thought it essential that this be convened swiftly and that its members should be able to have recourse to their own legal consultants. The Group had to devote its attention, first and foremost, to the legal issues associated with the payment of dividends in the knowledge that such issues had a direct bearing on the nature of the capital increase. He could not accept the idea of a Working Group consisting of a small number of Directors, or even Alternates, being charged with deciding on its own fundamental issues vital to the very future and existence of the Bank. He thought it preferable that the key subjects to be debated, namely the size and timing of the capital increase, the arrangements governing the **paid-in** element and the proportion of this in relation to subscribed capital as well as future strategy, should be given a thorough airing within the Board of Directors in the context of meetings attended perhaps by a limited number of participants. On that basis, the CHAIRMAN nevertheless agreed to consider the proposal made by Mr RAVASIO that the Working Group should be able to discuss not just legal questions but also other topics put to it by the Board. The CHAIRMAN proposed to chair a Working Group himself and undertook to put forward in the near future a timetable of meetings for the Group given over to tackling specific issues.

Replying to a number of other points raised by Directors, the CHAIRMAN added that, contrary to some of the views expressed, the proportion of **amounts lent in relation to estimated project cost** had increased. While the Bank should endeavour to keep to the **10%** guideline **for projects outside the Union** (in relation to overall lending), it was not easy to adhere strictly to this rule in view of the repeated requests from Member States that the EIB step up its activity outside the European Union. Indeed, the EIB had been requested, in particular, to make a significant contribution in the Central and Eastern European Countries; in this connection, the CHAIRMAN announced that a **Pre-accession Facility Paper** would soon be put to the Board. Finally, with respect to non-risk-weighted and risk-weighted lending he assured Directors that the Bank had analysed these in detail and had, in the process, sought the opinion of the rating agencies.

In the absence of any other remarks, the CHAIRMAN, summing up, concluded that, in response to the wish of some Board members to widen the remit of the proposed Working Party on legal questions, the Board itself, on a slimmed-down basis, should meet as a Working Group under his chairmanship to consider and make recommendations to the full Board on the central questions of the timing and terms of the next capital increase and the possibilities for a distribution to shareholders, together with the relevant wider aspects of the Bank's overall strategy for the next 5-10 years. He would circulate as quickly as possible proposals for meetings of this Group, together with a revised programme for the remainder of the Board's business, which could cover related issues such as the "modernisation" proposals which were still outstanding. The main objective would be to reach an agreed recommendation on these issues for presentation and decision by the Governors at the June 1998 Annual Meeting at the latest."

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